

<https://www.wealthmanagement.com/equities/morningstar-debuts-direct-indexing-offering>



Morningstar

INVESTMENT>EQUITIES

Morningstar Debuts Direct Indexing Offering

Direct indexing portfolios will be made available through the Morningstar Wealth Platform.

Rob Burgess | Nov 03, 2022

As Schwab IMPACT kicked off Tuesday, Morningstar debuted its new direct indexing offering.

Morningstar Direct Indexing brings together both in-house research and technology capabilities, including from Morningstar's Investment Management group, Morningstar Indexes, Morningstar Sustainalytics and Morningstar Equity Research.

Direct indexing portfolios will be made available through the Morningstar Wealth Platform to start.

Direct indexing helps enable advisors to use a portfolio optimizer to build a portfolio that tracks a broad index efficiently while typically buying all, or a subset of, the index holdings.

During an interview Tuesday at IMPACT, Daniel Needham, president of Morningstar Wealth Management Solutions, said they viewed direct indexing as an “important investment option for advisors to be able to deliver great advice to their clients.”

“That’s the primary reason we decided to enter the market,” said Needham. “We think that direct indexing is a good way for clients to be able to have their financial capital personalized, including their values, beliefs and preferences, as well as to be tax-managed for a lot of households. Tax management should happen for every household.”

Needham said they also viewed direct indexing as a technology solution as much as an investment strategy.

“You have to have all of these pieces to be able to deliver it,” said Needham. “For us, we’re really focused on building an intuitive digital workflow for direct indexing so that the advisor can really be able to implement it as efficiently and effectively as possible. And if we can deliver a productivity dividend back to the advisor, they can spend that time with their clients, maybe even grow their practice.”

Needham said the two main drivers of the increased interest in direct indexing have to do with tax management and also personalization.

“If you’re an individual who works for a company, let’s say you’ve been working there for a number of years, you’ve got some restricted stock units in the company, so you have some equity in the company,” said Needham. “Your income, your wages, your salary is paid by the company. That company operates within a specific industry. As you’re looking at your financial capital, you should also look at your human capital. ‘How tied am I to this industry?’ Just building an equity portfolio where maybe you downweight or reduce the exposure to the industry that person works in.”

Needham said direct indexing can help clients build a “more stable, holistic financial plan.”

“That’s an area that doesn’t get as much airplay as ESG, but it is just as important,” he said.

Needham said they viewed personalization as a growing factor in almost every facet of modern life.

“Why would financial services be any different? Direct indexing isn’t going to be for everybody. You need a broad set of solutions to be able to meet the diverse set of needs that clients have in the industry. We think direct indexing is one of the useful tools in the tool kit,” said Needham. “We think that direct indexing is going to be a really important solution for advisors who want to deliver great advice over the long term. We think we’re really well positioned to be a player in the industry to deliver solutions to clients. Like all of these innovations, it’s going to just take time to see how it plays out in the industry, but we’re pretty optimistic about the direct indexing opportunity, recognizing there needs to be a broad set of solutions.”

Asset managers, technology providers, and financial futurists have been talking about direct indexing for years, but the first big waves of acquisitions and rollouts to the retail advisory market began in 2020.

In July, First Trust Capital Partners announced plans Wednesday to acquire Veriti Management, a direct indexing asset technology company. Shortly before this, Baird and global asset manager RiverFront Investment Holdings announced they would take minority stakes in GAMMA Investing, a woman-owned investment firm providing custom index-based separately managed accounts to financial advisors.

Last December, Pershing announced it would acquire customized direct indexing provider Optimal Asset Management. In October, Vanguard said it closed on its acquisition of Just Invest, a wealth management technology company with a direct indexing offering, announced in July. Franklin Templeton announced in late September that it would acquire O’Shaughnessy Asset Management (OSAM), a quant-based money management firm that has a custom indexing platform.

Schwab and Vanguard continue to work on direct indexing offerings for retail investors, while Fidelity announced a do-it-yourself offering in June (Fidelity also offers a professionally managed option with a \$5,000 minimum to invest).